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SUBJECT: MONTENEGRO'S LARGEST EXPORTER CONTINUES TO FLOUNDER

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PODGORICA 00000063 001.2 OF 002

¶1. (SBU) SUMMARY: Podgorica's aluminum plant, KAP, has been struggling since at least mid-2008 to survive the impact of ongoing economic crisis. The low trading price of aluminum and expensive production inputs, particularly electricity, have resulted in daily losses of up to 200,000 Euros. KAP management is looking to the GoM for support during the crisis, but a possible agreement between the GoM and the plant's Russian owners has stalled over the latter's refusal to drop an international lawsuit against Montenegro for failure to disclose KAP's financial situation at the time of purchase. Since KAP is Montenegro's largest employer, with over 4,000 employees, and accounts for 14 percent of its GDP, the government is struggling to delay any hard decisions until after the March 29 elections.
END SUMMARY.

KAP's Rapid Decline

¶2. (SBU) Russian aluminum magnate Oleg Deripaska's Central European Aluminum Company (CEAC) bought KAP three years ago, and although the plant initially turned a profit, things quickly went south as the global economic crisis began to hit (reftels). KAP posted a loss of about 30 million Euros (roughly USD 39.6 million) in the first eight months of 2008, and had an increasingly difficult time keeping up with even basic payments (to input suppliers among others). Things have gotten so bad that the Electric Power Company of Montenegro (EPCG) has threatened to cut off the plant's power (although EPCG appears to have backed down for now, likely at the request of the GoM, which is EPCG's majority owner). Experts believe that with the steady decrease in world aluminum prices, it will be difficult for KAP to maintain its current production level (an output level of around 50 percent of capacity or 60 thousand tons of aluminum).

Too Big to Fail?

¶3. (SBU) The company's failure, however, would have enormous consequences for the Montenegrin economy. KAP is the country's largest employer, with over 4,000 employees (including those at the bauxite mines in Niksic), and its fortunes are tied to dozens of other large companies in the country, include the

state-owned Port and Railway Corporations. Further, KAP accounted for over 50 percent of Montenegro's exports in 2008 and 14 percent of its overall GDP. The plant's collapse would therefore deprive the GoM of substantial tax and payroll revenues and other fees. In addition, its closure would cause the GoM to incur the heavy cost - both monetary and political - of supporting thousands of newly unemployed citizens.

Seeking a Lifeline

14. (SBU) On March 2, Deputy PM and Minister of Finance Igor Luksic, Minister for Economic Development Branimir Gvozdenovic, and CEAC officials began negotiations with representatives of 17 banks in Vienna in order to obtain a loan for KAP. Though the GoM maintains publicly that an agreement could be imminent, the Austrian banks have not yet announced any decision. In fact, many of our independent interlocutors are sceptical that help from outside sources will materialize.

Only Point of Agreement: Let's Sue!

15. (SBU) A complicating factor in GoM-CEAC efforts to find a solution is the fact that the CEAC brought a 330 million euro suit against Montenegro in the International Arbitration Court in Frankfurt in early 2008, accusing the GoM of failing to fully disclose the plant's financial condition at the time of

PODGORICA 00000063 002.2 OF 002

purchase. The GoM claims that the contract was concluded only after months of negotiations, but several sources have told us that they believe CEAC's case is solid. In recent months the GoM has responded by threatening a lawsuit of its own, claiming that CEAC did not live up to its obligations under the privatization agreement, although it has yet to act.

A New Proposal

16. (SBU) On March 11, Branko Vujovic, Director of the Agency for Economic Restructuring and Foreign Investments, publicly outlined a new KAP rescue proposal. According to Vujovic, the GoM is prepared to prolong the deadline for KAP's payment of taxes and contributions, and to provide guarantees for a 20 million Euro loan. Vujovic did not say where this loan would come from, but our sources tell us that local bank CBK's parent bank, the Hungarian bank OTP, has agreed to provide the credit.

17. (SBU) In return, Vujovic said the GoM would require KAP to maintain its current level of production, prepare a restructuring program, and continue regular payment of salaries. The GoM also asked that the plant's owners pledge the assets from KAP's companies -- all of the processing section and 66 percent of the bauxite mine -- as a guarantee on the loan, and that CEAC drop its lawsuit against the GoM. Vujovic said the GoM would suspend its litigation against CEAC in return.

18. (SBU) However, CEAC promptly rejected the GoM's proposal, saying that it was not prepared to drop its arbitration case. According to CEAC, an offer of short-term assistance at such a high price was unacceptable. Nevertheless, the Government and CEAC have agreed to continue negotiations and to define both short- and mid- term solutions to the problems facing KAP.

Comment

19. (SBU) Negotiations on an assistance package for KAP have been ongoing for months, with the GoM intent on delaying any difficult decisions until after the March 29 parliamentary election and creating the impression for voters that a solution is imminent. However, a loan from the Austrian banks is a long-shot, and the possible GoM-CEAC agreement appears to have fallen victim to CEAC's unwillingness to give up its lawsuit. If KAP does not get a loan quickly, its management claim, it will be forced to begin bankruptcy proceedings in mid-April -- conveniently after the election. Clearly no solution is in sight, and the situation is growing increasingly untenable. The question now is how long KAP can survive after March 29. If (or when) KAP does go under, the Montenegrin economy is likely to face a more serious crisis.

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